

Agricultural Trade Policy in the Post-Uruguay-Round Era

Multilateralism, Regionalism, or Unilateralism

by
*Luther Tweeten**

Trade policies in the post-Uruguay-Round era can be characterized as unilateralism, regionalism, or multilateralism. Which "ism" prevails will mightily influence the course of world trade for decades to come.

Multilateralism

Multilateralism refers to global cooperation in trade negotiations and other means to serve the interests of participating countries. Such an approach served well through seven rounds of GATT negotiations, prior reciprocal trade agreements, and dispute settlement institutions. That global approach to world trade liberalization has lost momentum.

At this writing, the American Congress is debating whether to extend "fast-track" authority of trade negotiations for two years. Such authority is essential for the success of major trade negotiations because it allows only a simple approval-disapproval vote by Congress. (Allowing amendments to an agreement would mutilate accords, forcing negotiators back to the bargaining table with either a severely weakened or unacceptable proposal.)

* Anderson Professor of Agricultural Marketing, Policy, and Trade, Department of Agricultural Economics and Rural Sociology, The Ohio State University, Columbus Paper presented in Taiwan, ROC, April 1991

The merits of free trade, if ever in doubt, no longer can be denied. Countries such as Albania pursuing autarky have failed economically and socially while those such as the Newly Industrialized Economies (NICs) of Asia pursuing world trade have succeeded spectacularly. Why, in view of the theoretical and obvious practical benefits of free trade, is multilateralism on the brink of failure?

1. The Uruguay Round is failing because the European Community (EC) is unwilling to end trade distortions protecting its agriculture. The beggar-thy-neighbor agricultural policy of the EC is an abomination not only to others but also to itself. High domestic price supports generate surpluses either exported elsewhere with large subsidies or preempting a domestic market otherwise filled by imports. EC surplus production dumped on world markets lowers the level and stability of world prices. The policy cannot be defended on the basis of food security (the EC would retain a vast agricultural capacity even with free trade), preserving family farms (it isn't preserving such farms; other policies such as subsidies targeted to small farms would be more cost effective), serve infant industry (farming is a mature industry), or realize other defensible protectionist aims.

To be sure, the Common Agricultural policy (CAP) has held the European Community together. But there are several reasons why that situation is changing. First, elimination of internal border barriers (*Europe 1992*) and formation of a European Monetary System can replace CAP as the bonding agent. Germany, which has heavily bankrolled CAP, is now absorbed in its own problems of internal union and can ill-afford to continue large outlays for the CAP.

EC farming interest groups like those in many other developed countries exercise disproportionate power despite (some would say because of) agriculture's small share of EC population and gross product. The support for massive policy transfers comes from an aggressive, highly organized farm interest groups with disproportionate voting and lobbying power coupled with an indulgent, poorly informed public at large with nostalgic, romantic images of a past bucolic culture they think they are preserving.

It is possible to reconcile legitimate domestic policy objectives with free world trade. The rule is that what a country does in the sanctity of its own domestic "bedroom" is no one else's concern. But when its domestic policies deny legitimate opportunities for others, then domestic policies become a matter for international sanction rather than for national sovereignty. The goal in the Uruguay Round should have been to reduce border protection (and thinly disguised internal measures to the same end such as oilseed processor subsidies) rather than focus so much attention on the aggregate measure of support (AMS) for agriculture.¹ Countries should be left free to support their farmers as they like as long as they do not deny markets to other countries.

2. Another reason for disappointing GATT negotiations is because the most easily removed barriers to free trade already have been nearly eliminated. Tariffs once averaging approximately 50 percent have been reduced to 5 percent. Hardcore barriers remain. Nontariff barriers have replaced many tariff barriers and are especially intractable because they are neither transparent nor homogeneous. Diminishing returns to negotiators set in as the easily removed barriers fall, leaving behind agricultural and nontariff barriers which have proved unassailable in past negotiations.
3. The new economic order (NEO) world creates new challenges for multilateral negotiations. The NEO world is characterized by the breakup of the former east block out of economic weakness and of the west block out of economic strength and loss of a common foe. The NEO world recognizes that world influence and prestige come from economic, scientific, and technical rather than military prowess. (The latter cannot long be sustained without the former.)

The NEO world is characterized by three economic superpowers: the United States, the EC with Germany at the forefront, and Japan. Much of the impetus for free world trade has come

¹Border measures include variable levies, export subsidies, and tariffs. International agreements require a reduction in border measures without mandating unsavory policies calling for how domestic supports are to be handled.

from the preeminence of American economic and military might positioning the country to impose its moral position, including more open trade, on other nations. The relative decline of the American economy weakens its ability to impose free trade or any other moral position on other major economies.

4. The weakening of political liberalism compromises inertia for free trade. Much early impetus for free trade came from political liberals including President Franklin Roosevelt and the New Deal. The Heckscher-Ohlin synthesis seems to describe the real world: Free trade between countries increases returns to their relatively abundant factors of production used to produce commodities with a comparative advantage. The United States possesses a comparative advantage in high technology and popular culture (movies, television programming, music, etc.) because of a large domestic audience and an abundance of human talent and capital. Trade increases earnings for those who possess the talents to manage, perform, and innovate in the organizations and cultures of a highly technocratic society and decreases relative returns to those who must compete with automation, robotics, and third-world labor. Employment in labor intensive tradable goods and service industries such as textiles, clothing, footwear, and sugar are vulnerable to free trade. These industries press for protection in first-world countries. The protection game is also played by publishing, banking, insurance, domestic airline, and other service industries vulnerable to third-world human capital which can supply low-cost services.

Open trade widens the domestic income distribution by raising incomes of those who have the human capital in a technocratic society and lowering the incomes of those who because of lack of luck, motivation, or ability underinvested in human capital. Free trade raises the income of Michael Jackson relative to a unionized black assembly line worker. Free trade jeopardizes the auto, steel, and textile worker. They maintain their jobs only by accepting relatively lower wages than those enjoyed by their forbearers. In steel and auto industries, their forbearers bargained collectively as a monopoly union with a near monopolist seller of autos and steel not

worried much about competition from other countries. The world is a very different place today. Many politicians conclude that protectionism can maintain the old order of highly paid but relatively low-skill unionized production line workers. It can, but only at substantial cost in lost national income.

Various income transfer schemes have been proposed to narrow the widening income gap between the rich and the poor which is so vexing to Americans. Demogrant (a flat payment per person) and negative income tax (NIT) income maintenance programs have been rejected. I have proposed a wage-earnings supplement as an attractive alternative (see Tweeten and Brinkman, Ch. 6). Unlike the demogrant or NIT, the wage supplement encourages employment and helps relatively low wage American industries not easily able to compete with third-world imports. It especially targets the working poor.

5. A final reason for the troubles of multilateralism is the decline of encompassing institutions. It is ironic that America's recently demonstrated military brilliance in the Gulf is only exceeded by its incompetence at domestic economy. The most disgraceful failure is massive full-employment federal government deficits since 1983 -- a policy thoroughly condemned by mainline economists.

Because savings rates are relatively low in the United States and private individual and corporate savings are absorbed by private investment in the full-employment economy, the market signaled through high real interest rates that it wanted savings from abroad in the 1980s. To earn dollars for such savings, Taiwan, Japan, and other countries had to run trade surpluses with the United States. The market accomplished this through a low value of the dollar in international exchange. It was easy to import foreign goods and services but difficult to export American goods and services. This encouraged U.S. export subsidies and protection against foreign imports. The reverse occurred as the dollar fell in the later 1980s and early 1990s, encouraging foreign countries to subsidize their exports while protecting against American imports. This two-phased cycle of Reaganomics breeds trade distortions.

I have said that Reaganomics is largely the result of a decline of encompassing institutions (Tweeten, 1989, Ch. 3). Chief among these institutions is political parties which must take the long view of the political process from the standpoint of the nation as a whole. Parties' power has been usurped by political action committees (PACs) and television. A member of Congress can get elected by PAC contributions used to buy television time. The member owes special interests rather than encompassing institutions for his/her success. In the 1980s, the moral and intellectual high-ground in the White House took second place to immediate gratification. Unless the authority is restored of encompassing institutions such as political parties, Congressional leadership, and Congressional committees (as opposed to subcommittees), the nation and free trade will suffer. A start would be to allow PAC contributions to be made only to political parties and not directly to candidates. Public financing of political campaigns also would help and could be provided directly to political parties.

Regionalism

Failing multilateralism energizes regionalism. That trend is apparent in a more cohesive European Community and the U.S.-Canadian free trade agreements (FTA). A host of other free trade agreements are in various stages of implementation.

As yet, free trade agreements have been successful only among developed countries with common cultures. The European Community may expand to encompass members of the European Free Trade Association (Austria, Sweden, Norway, etc.) and former East Bloc countries (Poland, Czechoslovakia, and Hungary). The U.S.-Canadian free trade area may expand to include Mexico. President Bush has proposed that the Western Hemisphere become a free trade area.

What is the place of Japan, Taiwan, and South Korea in a world of regionalism? While oriental culture and proximity would suggest a free market of these three countries, old antagonisms die hard and may preclude

necessary cooperation. If North America and Europe successfully form free trade areas, the pressure will be intense for Asian nations to join together for countervailing power.

An alternative has some appeal. The principal of comparative advantage teaches that free trade areas have most to offer member nations that are most *unlike* rather than alike in resources and technology. Hence it would be well to encompass not just Japan, Korea, and Taiwan but the *Pacific Rim* in a wider free trade area. Such a Pacific Rim free trade area could encompass some combination of North America, Oceania, and Asean countries as well as oriental countries. Japan, Taiwan, and Korea might feel more comfortable together if mediated in an FTA with the United States, Australia, and New Zealand. Countries with very high man/land ratios would feel greater food security and be more willing to forsake self-sufficiency in rice if adequate assurance could be given among FTA partners that food will not be used as a weapon and that markets would remain open under any circumstances.

Food security remains a critical issue. Less antagonism with the Soviet Union reduces chances of a major conflict interrupting food supplies. These considerations enhance opportunities for a broad FTA. Reassurances aside, legitimate doubts about the reliability of food suppliers will persist -- an issue to be addressed later.

A world of regionalism and FTAs could be a world of greater rather than less nationalism. Large nation-states have emerged in part to attain advantages of specialization and economies of size. If a nationalist entity such as Slovenia, Slavakia, Quebec, or Latvia can secure these advantages by joining a common market, then each is in a position to exercise nationalistic impulses and split off from its current nation-state. Thus regionalism is not inconsistent with the rise of nationalism; the FTA in essence makes the world safe for nationalism.

By freeing trade within the area, intra-area trade is likely to expand at the expense of trade with outside nations. The test of trade enhancement versus displacement depends on how protectionist the area becomes to outsiders and how free is internal trade. In theory, *world* free trade is preferred to *regional* free trade. However, it may be argued that the sense of community and security in regional FTAs make possible greater liberalization by regionalism than by multilateralism. Thus, regionalism may be preferred on efficiency grounds. A serious

shortcoming of regionalism is that it can lead to intense and predatory economic (and perhaps military) confrontation among FTAs. For that reason it is important that multilateralism not be abandoned.

Unilateralism

Unilateralism means that each nation formulates its own trade policies without consultation or collaboration in wider trade forums. With each nation acting in its self-interest, confrontation rather than cooperation is likely to be all too frequent. An advantage of unilateralism is that it can reduce collusion to distort prices. But it also reduces opportunities to remove trade distortions that reduce the general welfare.

Unilateralism would appear to benefit large-country traders such as the United States. While that may be true, it does not necessarily follow that a large country's gains come at the expense of small countries.

To illustrate, I contend that the optimal trade strategy for the United States is in sequential order:

1. Global free trade.
2. If (1) is not possible, the second best policy is confrontation with non-free traders, resulting in liberalization and global free trade.
3. If the second best policy is not feasible, the third best policy is unilateral American free trade even if other nations chose to distort trade.
4. The most unsatisfactory policy is continuing confrontation in the absence of success in removing trade barriers of other countries.

Because global free trade is not feasible, the United States has turned to the second best policy of confrontation. In this it has a powerful tool called *Super 301* created by the Omnibus Trade and Competitiveness Act of 1988. In addition, it uses voluntary restraint agreements or quotas and export subsidies. *Super 301* tactics are controversial and have plenty of supporters and critics. Notable observations are that:

1. Some justify confrontation tactics, contending that such measures merely force nations to do what would be in their best interests to do if they had more perfect trade and political systems. These countries, it is argued, would unilaterally remove trade distortions if they were not held

hostage to powerful domestic special interests demanding protection. *Super 301* gives cover for countries to do what a more perfect domestic political and economic system would do.

2. The counter agreement is that all countries maintain trade distortions which have been delicately and diplomatically balanced through trade negotiations. It is unfair and in violation of GATT rules for a powerful nation to upset the balance by unilateral confrontation to win trade concessions. Arguments that confrontation serves the general welfare of the trade-distorting nation demonstrates arrogance (it presumes knowledge of another country's social welfare function) and disrespect for sovereignty. Rather, it is argued, the better solution is to let neomercantilist nations continue to "shoot themselves in the foot" until they realize that the wealth of nations derives from how well its citizens live rather than how well the Treasury accumulates foreign exchange reserves.
3. A country such as India (singled out by the U.S. under *Super 301*) may out of national pride and sovereignty hold out against liberalization despite penalties imposed by the U.S. The economic damage to India may be considerable both from its self-imposed distortions and retaliation by the U.S. But America has nothing to gain from an economically weakened India. Continued sanctions by the U.S. against a stubborn country unwilling to end distortions makes both the U.S. and the offending country losers.

With disappointing success of GATT negotiations and hence multilateralism (option 1 above), the second best alternative for the United States is confrontation with countries that protect against imports, subsidize exports, and pursue neomercantilism. As a powerful trading nation, America has had and will continue to achieve some success with this strategy. *Super 301* has already won some concessions. Brazil, Korea, and India have been singled out, but none has been the target of major U.S. retaliation either because concessions have been made or the U.S. has not pressed the issue as in the case of India.

Rightly or wrongly, the United States will continue to use *Super 301* to obtain trade concessions. Such confrontation will not always be successful. A price war of export subsidies transfers wealth from the antagonists,

such as the U.S. and EC, to others. American retaliation against cheap imports hurts American industry and consumers alike.

If retaliation does not succeed in a reasonable period of time as is the case of the U.S. Export Enhancement Program (EEP) designed mainly to penalize the EC for expanding its wheat and flour export markets with massive export subsidies, the best strategy is unilateral liberalization (option 3 above).

That leaves option 4 above, continued unsuccessful retaliation, the worst strategy. Unfortunately, that appears to be the course both the U.S. and European Community are determined to follow.

American farmers have a major stake in multilateralism over unilateralism. It is notable that either approach to end American agricultural trade distortions was estimated to add approximately \$4 billion annually to U.S. national income or deadweight gain in the mid-1980s (Anderson and Tyers; Roningen et al.). The distribution of benefits and costs would be quite different, however. Multilateralism would reduce support prices in distorting countries, lowering production, raising world price, and raising income of U.S. farmers because they receive the world price. Farmers and taxpayers would gain \$4 billion more than consumers would lose from higher food prices. Unilateralism would reduce U.S. prices as our supply controls are removed without any compensating changes abroad. The result would be that consumers and taxpayers would gain \$4 billion more than producers would lose.

Strategy for a Developing Country

What strategy is appropriate for countries wishing to protect domestic industry in the face of threatened U.S. retaliation? My judgment is that free trade with few exceptions improves national welfare. Traditional arguments to protect agriculture from foreign competition are weak: protection is essential to preserve an infant industry (most protected farming industries are old and inefficient), to maintain family farms (that can be done at less national income loss by direct payments), and to maintain the rural community (not an efficient way to preserve rural communities, most of which may not rely on farming anyway).

Perhaps an exception is justified for national security. My personal view (not necessarily deriving from sound professional economics) is that every country should have the right to supply from internal sources a major portion of one food staple. In the case of Asia, that would usually be rice. Two main reasons prompt my vote to allow countries such as Taiwan self-sufficiency in a major staple:

1. The memories of World War II remain real to many, and countries need some even modest security against starvation in times of international conflagration.
2. The U.S. government, despite reassurances to the contrary, is likely to continue to use food as a weapon. True, embargoes have been counterproductive, hurting Americans more than the intended victims. And legislative attempts have been made to discourage use of embargoes -- partly by imposing such large compensation to farmers that the U.S. Treasury cannot afford the loss. Despite such developments, America will continue sporadically to use food as a weapon as it did to Iraq.

To be sure, American rice growers do not agree with my position. They will continue to press unfair trade charges before GATT, Congress, and the American public. But American rice growers need to be cautious. They too are heavily subsidized by price supports, direct payments, and (in California) underpriced irrigation water. That undermines their moral position and brings charges of hypocrisy -- hardly the way to win a public relations war.

On the other hand, great concern with interruption of food trade under a global nuclear conflict is unjustified. The probability of global nuclear conflict is small indeed. The war would be over in short order. Brushfire wars such as in the Gulf do not interrupt supplies. Petroleum imports used to supply fertilizer and pesticides for domestic food production are as likely to be interrupted as food imports.

Conclusions

The world trading community stands at a crossroad. The various paths lead to multilateralism, regionalism, and unilateralism. To move forward economically in the 1990s, the world needs a new frontier of

opportunity in expanded aggregate demand. That would be best achieved by multilateralism -- with success of GATT negotiations. A major benefit of a highly successful GATT outcome is that it would slow growth of the more pernicious forms of regionalism and unilateralism.

Because it can reduce internal trade barriers within a free trade area, regionalism need not necessarily be trade distorting. Regionalism can be a force for free trade as exemplified by the United States viewed as a free trade area. In contrast, the European Community has been a force for external protectionism and world welfare losses. The danger is that, in the new world economic order featuring intense rivalry among economic superpowers, the EC rather than the U.S. could be the model of the future.

Unilateralism at worst is a world without trading rules, a return to the "jungle" featuring survival of the fittest. The strong wresting trade concessions from the weak have no one to discipline their own abuses. Unilateralism is not to be confused with pure competition in trade. On the contrary, a well-functioning competitive world trade market in which all parties to trade gain is best fostered by multilateralism in which the rules for trade remove distortions of the strong and the weak alike.

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